

MEMO# 28525

November 13, 2014

CFTC Proposes to Exclude Commodity Trading Advisors from Oral Recordkeeping Requirement

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 78-14
REGISTERED FUND CPO ADVISORY COMMITTEE RE: CFTC PROPOSES TO EXCLUDE
COMMODITY TRADING ADVISORS FROM ORAL RECORDKEEPING REQUIREMENT

The Commodity Futures Trading Commission (“CFTC”) recently proposed amendments to Regulation 1.35(a) under the Commodity Exchange Act (“CEA”), which addresses recordkeeping requirements applicable to certain market participants, including a member of a designated contract market (“DCM”) or a swap execution facility (“SEF”), with respect to transactions relating to their business of dealing in commodity interests. [\[1\]](#) Among other things, the Proposed Amendments would expand and make permanent the temporary no-action relief that the CFTC staff granted to commodity trading advisors (“CTAs”) that are members of a DCM or SEF to exclude them from the requirement to record all oral communications that lead to the execution of a transaction in a commodity interest. The CFTC requests comment on the Proposed Amendments within 60 days of publication in the Federal Register. The Proposed Amendments are summarized briefly below.

Background

The CFTC explains that it amended Regulation 1.35(a) at the end of 2012 to integrate the rule more fully with the Dodd-Frank Wall Street Reform and Consumer Protection Act. [\[2\]](#) Regulation 1.35(a) requires futures commission merchants, retail foreign exchange dealers, introducing brokers, and members of a DCM or SEF to retain records of all oral communications that lead to the execution of a transaction in a commodity interest, in addition to retaining various written records. [\[3\]](#) Currently, the requirement under Regulation 1.35(a) to record oral communications does not apply to: (i) oral communications that lead solely to the execution of a related cash or forward transaction; (ii) certain oral communications provided or received by a floor broker; (iii) certain introducing brokers; (iii) commodity pool operators; (iv) swap dealers; (v) major swap participants; or (vi) a member of a DCM or SEF that is not registered or required to be registered with the CFTC.

Subsequent to the 2012 amendments to Regulation 1.35(a), the CFTC staff issued several no-action letters granting relief with respect to entities that are subject to the rule as a result of being members of DCMs and SEFs. [4] The staff granted relief with respect to CTAs [5] and certain end-users. [6]

The CFTC no-action letters with respect to CTAs granted time-limited no-action relief, the latest of which extends through December 31, 2014. The letters generally granted relief from the requirement for CTAs that are members of SEFs and DCMs to record oral communications in connection with the execution of swap transactions pursuant to Regulation 1.35(a). [7]

In a letter providing relief to end-users, the CFTC staff recognized that certain end-users are members of DCMs and SEFs, but are not otherwise required to be registered with the CFTC and are not acting on behalf of a customer. These end-users are exempt from the requirement to record oral communications, but are still subject to the requirement to retain written communications. [8] The CFTC staff granted limited no-action relief with respect to the requirement that these end-user DCM and SEF members keep digital or electronic written communications, specifically with respect to keeping text messages, and granted no-action relief with respect to the requirement under Regulation 1.35(a) that records be kept in a form and manner identifiable and searchable by transaction. [9]

Proposed Amendments

The CFTC explains that it is considering the Proposed Amendments in order to address concerns regarding the applicability of Regulation 1.35(a) to CTAs and end-users raised by market participants in the requests for no-action relief, discussed above, as well as concerns raised by participants during a public roundtable hosted by the CFTC to discuss end-user issues in April. [10] The Proposed Amendments would make the following changes to Regulation 1.35(a):

- Exclude CTAs from the requirement to record and maintain oral communications. [11] The CFTC acknowledges that many CTAs that are members of a DCM or SEF have discretionary trading authority over their customers' accounts and typically would not be expected to have telephone conversations with customers that lead to the execution of an order. The CFTC notes, however, that it is not proposing to relieve members of a DCM or SEF that are CTAs from the written recordkeeping requirements of Regulation 1.35(a) because it believes certain CTAs may execute orders for customers on a non-discretionary basis, or may receive instructions changing or limiting their discretionary authority. [12]
- Clarify the "identifiable" and "searchable" requirements of the rule. The Proposed Amendments would revise the rule so that all required records must be searchable, but not "searchable by transaction," as Regulation 1.35(a) currently requires. The CFTC clarifies that the requirement that all required records be "identifiable by transaction" means records must be kept in a form and manner that allows for identification of a particular transaction, with certain exceptions.
- Clarify that records of oral and written communications that lead to the execution of a transaction be searchable, but need not be kept in a form and manner that allows for identification of a particular transaction. Regulation 1.35(a) requires that records of oral or written communications that lead to the execution of a transaction must be maintained in a searchable format. The CFTC proposes to clarify that these records must be searchable, but are not required to be kept in a form and manner that allows

for identification of a particular transaction. [13]

- Exclude unregistered members of DCMs or SEFs from the requirements to retain text messages and to maintain required records in a particular form and manner. The CFTC explains that many end-users that meet the definition of “member” of a DCM or SEF are not registered or required to register with the CFTC. These end-users have explained that they typically communicate regarding their commodity interest trading orders via text messaging, and that it is too expensive for them to retain text messages. The Proposed Amendments would exclude these unregistered members from the requirement to retain text messages. The Proposed Amendments would also exclude these unregistered members from the requirements under Regulation 1.35(a) to keep records in a searchable format and in a form and manner that allows for identification of a particular transaction.

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endnotes

[1] Records of Commodity Interest and Related Cash or Forward Transactions, available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister110314b.pdf> (“Proposed Amendments”). The Proposed Amendments are scheduled to be published in the Federal Register on November 14, 2014.

[2] See Adaptation of Regulations to Incorporate Swaps—Records of Transactions, 77 FR 75523 (Dec. 21, 2012).

[3] Specifically, Regulation 1.35(a) requires that records be kept of “all oral and written communication provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a transaction in a commodity interest and related cash or forward transactions, whether communicated by telephone voicemail, facsimile, instant messaging chat rooms, electronic mail, mobile device or other digital or electronic media . . .” The rule also requires additional written records. Unlike the written recordkeeping requirement under Regulation 1.35(a) that applies to transactions in a commodity interest and related cash or forward transactions, the oral recordkeeping requirement is limited to transactions in a commodity interest.

[4] “Member” is defined under the CEA as: an individual, association, partnership, corporation, or trust (A) owning or holding membership in, or admitted to membership representation on, the registered entity or derivatives transaction execution facility; or (B) having trading privileges on the registered entity or derivatives transaction execution facility. See Section 1a(34) of the CEA.

[5] See CFTC No-Action Letter No. 14-60 (Apr. 25, 2014), available at <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-60.pdf> (“CFTC No-Action Letter No. 14-60”); CFTC No-Action Letter No. 14-33 (Mar. 21, 2014), available at <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-33.pdf>; CFTC No-Action Letter No. 13-77 (Dec. 20, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-77.pdf> (“CFTC No-Action Letter 13-77”).

[6] See CFTC No-Action Letter 14-72 (May 22, 2014), available at <http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-72.pdf> (“CFTC No-Action Letter No. 14-72”).

[7] CFTC No-Action Letter 13-77, which expired on May 1, 2014, granted no-action relief to CTAs from the requirement to record oral communications under Regulation 1.35(a) with respect to all commodity interest transactions covered by the rule, while CFTC No-Action Letter 14-60 granted relief to CTAs only from the requirement to record oral communications in connection with the execution of swap transactions under the rule.

[8] CFTC No-Action Letter No. 14-72, *supra* note 6.

[9] The relief provided by CFTC No-Action Letter 14-72 remains effective until the effective date of any final CFTC action in response to the letter requesting the relief, including without limitation a rulemaking, an order, or a determination not to take action with respect to the letter.

[10] Public Roundtable to Discuss Dodd-Frank End-User Issues, Commodity Futures Trading Commission (Apr. 3, 2014), available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript040314.pdf>.

[11] Note that this relief is broader in scope than the relief currently in effect under CFTC No-Action Letter 14-60, because it would extend to oral communications that lead to the execution of a transaction in any commodity interest, and not just swap transactions. See *supra* note 7.

[12] The CFTC also notes that it considers the costs to CTAs of recording and maintaining these written records to be “significantly less” than the costs to maintain oral communications. Proposed Amendments, *supra* note 1, at 17.

[13] The CFTC explains that this means “that there would be no requirement for a market participant to link or otherwise identify a record of a communication that leads to the execution of a transaction with a particular transaction.” Proposed Amendments, *supra* note 1, at 14.

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